No. 91-1842

(3)

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

CHARLES MCCRORY, *et al.*,

Petitioners,

—v.—

THE RESOLUTION TRUST CORPORATION,

Respondent

REPLY TO BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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ARGUMENT

Respondent fails completely to address or refute the arguments presented by the Petitioners in seeking the review of this Court.

I. CONTRARY TO RESPONDENT'S POSITION, THE ISSUE IS NOT FACT-BOUND

The statute in question, 28 U.S.C. § 1823(e), sets forth four requirements, all of which must be satisfied before any agreement against the interest of the Resolution Trust Corporation ("RTC") will be considered valid.

There is no question that the Letter of Agreement satisfies the first three requirements of the statute, in that it

> (1) is in writing,
>
> (2) was executed by the depository institution and any person claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by the depository institution,
>
> (3) was approved by the board of directors of the depository institution or its loan committee, which approval shall be reflected in the minutes of said board or committee. . . .

28 U.S.C. §§ 1823(e)(1)-(3).

At issue in this case is the satisfaction of the fourth requirement that a document which fulfills the first three requirements of this statute *also* be an agreement that "has been, continuously, from the time of its execution, an official record of the depository institution." *Id.* at § 1823(e)(4).

Although Respondent is correct to observe that the court below did not "promulgate any comprehensive definition of 'official record' " (Pet. App. A8), Respondent errs (Respondent's Brief at 6) in insisting that this case presents only a fact-bound determination that does not warrant review by this Court.

The decision of the court of appeals that "the 'draft (documents)' file of the bank's outside attorney does not constitute 'an official record of the depository institution,' " (Pet. App. A8) essentially presupposes a definition of this term that indeed completely and unjustifiably deviates from the reasons for the enactment of the statutory provision. This interpretation places borrowers who have dealt fairly and in good faith with failed depository institutions in a position of strict liability in the face of their own complete inability to control the record-keeping practices of the institution. It gives an interpretation of the statute far beyond the purposes for which it was enacted. Petitioners therefore seek review by this Court of such interpretations of the statute.

II. CONTRARY TO RESPONDENT'S POSITION, *LANGLEY v. FDIC* IS NOT DISPOSITIVE OF THE ISSUE PRESENTED

Respondent incorrectly asserts that this Court's decision in *Langley v. FDIC*, 484 U.S. 86, 91 (1987) is dispositive of the issues on which Petitioners seek review, because the court of appeals' decision furthers the RTC's ability to evaluate the financial condition of a failed lending institution "with great speed, usually overnight, in order to preserve the going concern value of the failed bank and avoid an interruption in banking services." *Id.* In *Langley*, *id.* at 91, this Court noted that "[o]ne purpose of section 1823(e) is to allow federal and state bank examiners to rely on a bank's records in evaluating the worth of the bank's assets" with the requisite speed to avoid disruption of banking practices. The efficiency of the examiners' review cannot be elevated to a concern that may trample the rights of borrowers in the manner permitted by the court below.

It is the FDIC's practice to sell a failed bank's performing assets to a purchasing bank, with that purchasing bank assuming the liabilities of the failed bank. The FDIC then makes up the difference between the value of the liabilities assumed by the purchasing bank and the actual value of the assets acquired. This system is designed to ensure that there is no interruption

in the availability of deposits and the resultant erosion of confidence in the banking system.

The interpretation of the statute that led the court of appeals to conclude that the Letter of Agreement at issue in this case did not meet the statutory requirements poses a considerable threat to the rebuilding and maintenance of confidence in the shaken banking system, confidence that the actions of the government regulators seek to ensure. When borrowers who have taken such steps as those of the Petitioners are precluded from raising a properly executed document, in the continual possession of the agent of the bank who had the power to bind the bank at the closing of this agreement, as a defense to liability which they had taken all possible steps to limit, consumer confidence is severely threatened. The court of appeals interpreted the statute in a way that allows the lender to avoid his contractual obligations in a way that merits the review of this Court.

The ability of the FDIC to swiftly review and evaluate the financial health of an institution is not the *only* purpose behind the statute's provisions, and Respondent is therefore incorrect in its conclusion that "[r]elying on that reasoning, the court of appeals correctly held that a document located outside a thrift's premises in an attorney's file not ordinarily used to store executed documents would not have been available to banking examiners who needed to ascertain quickly and accurately the value of the thrift's assets and liabilities." Respondent's Brief at 6-7.

The theory behind the doctrine of *D'Oench, Duhme & Co. v. FDIC*, 315 U.S. 447, 460 (1942) sought to prevent the use of a secret agreement, "a scheme or arrangement whereby the banking authority . . . was likely to be misled," as a defense against the FDIC. In light of this principle, the *Langley* court held that "agreement" in this context should not be given a narrow interpretation which "encompasses only an express promise to perform an act in the future." 484 U.S. at 90. The *Langley* court concluded that such a cribbed interpretation would not be consonant with the principles behind the statute:

> We can safely assume that Congress did not mean "agreement" in section 1823(e) to be interpreted so much more narrowly than its permissible meaning as to disserve the principle of the leading case applying that term to FDIC-acquired notes. Certainly, one who signs a facially unqualified note subject to an unwritten and unrecorded condition upon its repayment has lent himself to a scheme or arrangement that is likely to mislead the banking authorities, whether the condition consists of performance of a counterpromise (as in *D'Oench, Duhme*) or of the truthfulness of an warranted fact.

Id. at 92-93.

Yet, the court of appeals' interpretation of the statute here, interpreting "official record" in such a manner as to prevent the assertion of a defense to liability based on a properly authorized and executed agreement that was continuously held in the client files of the bank's attorney in the very same building as the bank, also "disserves the principle of the leading case" in the area. *Id.* The application of the *D'Oench* doctrine in a manner which almost blindly favors the interests of the FDIC results in outcomes that are contrary to the history and policy of this doctrine.

III. THE DECISION BELOW RENDERS BORROWERS GUARANTORS OF THE LENDER'S FILE MAINTENANCE

Petitioners do not dispute that in the transition from case law to statute, the *D'Oenche, Duhme* requirement of borrower fault, wherein a borrower who enters into a fraudulent arrangement may not assert the undisclosed defense with clean hands, was transformed in 12 U.S.C. § 1823(e). The decision of the court of appeals, however, also removes any possibility of the consideration of the fault of the failed bank to protect its interests, to which the RTC has succeeded.

The decision below is cast, not so much in terms of strict liability, but in rendering the borrower, who has done every-

thing in his power to properly limit his liability with the agreement of the lending bank, a guarantor of the bank's ensuring that it maintains its document files in such a manner that the borrower will be able to raise the defense of limitation of liability against the FDIC or RTC. This interpretation will inject an element of uncertainty for those who enter into transactions with financial institutions which will be extremely harmful at a time when confidence in the stability of the banking system is low. It is the result of an unnecessarily and unjustifiably broad interpretation of this statute.[1]

The court of appeals held that the document was not an "official record" for purposes of section 1823(e)(4). There was no reason offered by the court in coming to this conclusion other than the fact that the original executed agreement was not in the files of the bank's offices themselves. It was rather in the continuous possession of its agent, the agent who had closed on the very assumption agreement which the RTC wishes to enforce against Petitioners.

Respondent argues that Petitioners err in stating that the court of appeals essentially recognized a location-specific requirement in the language of the statute. Under the analysis below, however, the arguments that prevailed in leading the court of appeals to reject a defense to the borrowers' liability based on a properly-executed document—held in the client files of the bank's outside counsel who closed the transaction, held continuously in the same building as the bank's offices, referred to in other document in the bank's files—could likewise justify the prevention of documents held in off-site storage from being considered valid defenses against the borrower's liability to the RTC.

Petitioners noted that the language of § 1823(e)(4) is broad (Pet. 8), and neither the court below, nor Respondent's Brief offer any reason why a properly approved and executed docu-

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1 *See* Warren L. Dennis & John R. Simon, *Litigation with the FDIC and the RTC: The Evolving* D'Oench *Doctrine Superpower Defense*, 47 Business Lawyer 1319, 1323 (1992) ("the modern extension of the *D'Oench* doctrine actually may *undermine* rather than buttress confidence in the federal banking system.").

ment in the custody of the bank's agent is not an official record of the transaction. Respondent has not offered any reason why, under the analysis that it urges, a document in off-site storage, a common method of maintaining client files, should be viewed any differently from the Petitioners' agreement held in the offices of the bank's attorney. This interpretation of the statute will significantly undermine the confidence of financial institutions that is sorely in need of restoration after the failure of so many such institutions.

IV. THE STATUTE SHOULD BE INTERPRETED IN A MANNER THAT PROTECTS THE RIGHTS OF THE GOVERNMENT AND THE BORROWER

If the decision of the court of appeals is allowed to stand, petitioners will be faced with the execution of a judgment which they could not have anticipated, and from which they took steps to insulate themselves from liability with the very same officer who also closed on the assumption on behalf of Old Sunbelt.

John Fox, Old Sunbelt's outside counsel, received an executed copy of the Letter of Agreement at the closing on the assumption transaction. RTC looks to his role as an agent of the bank as the grounds for Petitioner's liability. It performs an analytical about turn, however, to argue that an executed copy of the Letter of Agreement, maintained by Fox in his client file, cannot act as its intended limitation of liability for Petitioners. That Fox mistakenly placed the originally executed document in his client file rather than placing it with the assumption documents was not the fault of the Petitioners. It was not within their knowledge or control. The document was in the uninterrupted control of the agent of the bank who had the power to close a transaction in which petitioner's liability was limited by a fully executed document of which the bank was aware, and to which the bank referred in its files. To interpret the language of section 1823(e)(4) in a way that excludes such a Letter of Agreement from the definition of "official record of the depository institution" is to interpret the statute in a way that rec-

ognizes neither the purposes for which it was enacted nor the everyday operations of banking institutions."

Contrary to Respondent's assertions (Respondent's Brief at 7), this argument does not require that a court determine that the equities favor petitioners. As noted by this Court in *Langley*, "Congress opted for the certainty of the requirements set forth in section 1823(e). An agreement that meets them prevails even if the FDIC did not know of it; and an agreement that does not meet them fails even if the FDIC knew." 484 U.S. at 95. Contrary to Respondent's argument, therefore, Petitioners do not ask this Court to ignore its refusal in *Langley* "to engraft an equitable exception upon the plain terms of the statute" 484 U.S. at 94, but rather recognize that the plain terms of the statute require no such interpretation, and that the realities of the banking world militate against the interpretation of the statute in a manner that gives the RTC protections that it does not need and to which it has no necessary right under the statute.

The court of appeals concluded that it must interpret the statute in a way that left Petitioners without the defense of limitation of liability to which they were otherwise entitled. The RTC wants to recognize the assumption on which the bank closed through its agent, but not the contemporaneous limitation on the borrowers' liability. An interpretation of this statute that allows a bank to select a method of storing its documents that will defeat valid defenses that its borrowers have effected in good faith, an interpretation effectively embraced by the opinion of the court of appeals, is an outrageous twist of the policy underpinning this statutory scheme. The RTC can protect its legitimate interests by alternate means that do not so trample on agreements executed by the bank whose liabilities the RTC assumes.[2]

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2 *See* Petitioners' Brief at 15-16. *See also* Kevin A. Palmer, *The* D'Oench *Doctrine: A Proposal for Reform*, 108 **Banking Law Journal** 565, 574-75 (1991) ("Just as banks maintain loan loss reserves on the proven assumption that certain loans will not perform, the FDIC should build a default factor into its evaluation to cover contingent losses").

The ability of the FDIC to evaluate quickly the status of the failed institution is of considerable importance to the shaken confidence in banking institutions in the United States. The FDIC must rely on the books and records of the failed bank in order effect an expeditious evaluation of the bank's assets. In order to make this rapid appraisal,

> [a] premium is placed upon speed over accuracy and fairness. While it cannot be denied that the integrity of the banking system depends on prompt action by the FDIC, it should not be at the expense of a fair evaluation of the bank's asserts or preservation of legitimate borrower rights. . . .
>
> The effect of favoring speed over accuracy is to shift the burden of the losses from the failed bank from the taxpayers generally, who indirectly fund the FDIC's deposit insurance, to the few unlucky debtors having real defenses who get caught in the web of 12 U.S.C. section 1823(e).[3]

Petitioners' situation is a vivid example of the problems of such an interpretation of the statute. Petitioners noted (Pet. 12) that there was no way that, as parties to the Letter of Agreement, they could ensure that a copy of the agreement into which they had entered with the bank to limit their liability was maintained in the bank's on-site files at the time that the institution was taken over by the government regulators.

Petitioners executed the document and kept a copy of that Agreement in their own files which they were able to present to the proper authorities when they were sued for the amount against which they had limited their liability. They were represented by counsel at the closing on the assumption and saw the Letter of Agreement, which had been properly signed by a senior loan officer of Old Sunbelt being given into the custody of Old Sunbelt's representative, agent and attorney, Fox. That executed document was found in the client files of John Fox and produced as evidence of the limitation of liability agree-

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3 *See* Palmer, supra note 2, at 574-75.

ment. The agreement had been in the continuous possession of the bank's agent in the closing binder for that transaction that the bank's agent maintained in the very same building, on the very same floor as the bank's offices. There is no question, considering the policy and case law behind this requirements, that this chain of custody of a properly executed and delivered document should be considered as meeting the requirements of the statute as a document that "has been, from the time of its execution, an official record of the depository institution."

The limitation of liability executed by the Petitioners with the failed institution is not the type of side agreement that the *D'Oench, Duhme* doctrine and the statute sought to prevent. Interpretation of the statute in a manner which is so out of accord with the policy behind *D'Oench, Duhme* has already been rejected by this court in *Langley*, and should be rejected once again in the instant case.

The Fifth Circuit has otherwise observed that "[w]hen the FDIC assumes control of an institution, the assets are what they are . . . . We agree that the FDIC should not be disadvantaged by the circumstances of its assumption of control, but this policy does not require giving the FDIC the ability to transmute lead into gold."[4] The court of appeals performed just this sort of impermissible "alchemy" when it rejected the defense of the Letter of Agreement to the Petitioners' liability to the RTC. The decision of the court of appeals should be reversed, as an impermissible extension of the rights of the FDIC under the statute, in derogation of the rights of innocent borrowers whose interests are sacrificed to the machinery of government.

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4 *Sunbelt Sav., FSB Dallas, Texas* v. *Montross*, 923 F.2d 353, 357 (5th Cir.), *reh'g granted*, 932 F.2d 363 (5th Cir.), *reinstated, in part, remanded*, 944 F.2d 227 (5th Cir. 1991).

CONCLUSION

For these reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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